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Joining the global rules-based economy: Challenges and opportunities for the GCC

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Abstract:
A transcript of the twentieth in a series of Capitol Hill conferences convened by the Middle East Policy Council which took place on Feb 1, 2000, is presented. Whether the Gulf States are ready to join the rest of the world in adhering to the global rules-based economy is discussed.

Full Text:

[Headnote]
The following is an edited transcript of the twentieth in a series of Capitol Hill conferences convened by the Middle East Policy Council. The meeting was held on February 1, 2000, in the Dirksen Senate Office Building with Chas. W Freeman, Jr., moderating.

CHAS. W. FREEMAN, JR., president, Middle East Policy Council

It is my pleasure to welcome you here this morning for a discussion of a topic that is much less noticed, and much less under discussion in Washington than it should be. Throughout the Gulf, wherever you go these days, if you talk to rulers, you will find that they are all focused on economic reform and how to increase the rate of return on investment and open up their economies. All of them see accession to the World Trade Organization (WTO) and other market-opening moves as essential to bringing their economies into a more competitive situation vis-A-vis foreign investment and trade. Today we are gathered to talk about whether the Gulf States are now ready to join the rest of the world in adhering to the global rules-based economy. This is the direction of the thinking of rulers in the Gulf, but the implementation of it will be difficult. There is probably no other region of the world which has been quite as distinctive in the development of its own pattern of commercial and investment practices as has the Arabian Gulf in the period since oil was discovered and the region went from extreme poverty and minor trading activity to sometimes great wealth.

CECILIA KLEIN, WTO Accesions, Office of the U.S. Trade Representative

I would like to discuss where accession to the World Trade Organization (WTO) and U.S. trade policy fit in the larger picture of economic development and expansion in the Middle East. Of the countries in the Gulf Cooperation Council, all six have a WTO connection. Four of them were contracting parties to GATT (General Agreement on Tariffs and Trade) 1947, and they became original members of the WTO at the time it was implemented in January 1995. Saudi Arabia and Oman are exceptions. They did not have a previous GATT relationship, and therefore applied for membership in the WTO through the formal accession process provided for in Article 12 of the WTO Agreement. Saudi Arabia first approached the GATT during the 1980s but did not at that time request accession, or membership, to the organization. Saudi Arabia remained an observer in the GATT through the period of the Uruguay Round. Towards the end of that period, in April 1993, Saudi Arabia applied for WTO accession. Oman became an observer in 1995 and applied for WTO accession in 1996.

WTO accession is a rigorous process involving review and discussion of an applicant's entire trade regime and the undertaking by the applicant of specific commitments on tariffs, services, and agricultural supports and subsidies, and compliance with WTO rules. But the most important commitment a country makes when it decides to become a WTO member is to use the World Trade Organization's rules, agreements and procedures as the basis for its trade policy now and into the future.

It's very clear that the principles of the WTO, including greater liberalization, transparency, stability, predictability and application of the rule of law in trade matters are issues under active discussion in each of the GCC countries. In the WTO context, the sharpest focus now is on Oman and Saudi Arabia because they are actively negotiating the terms of their WTO membership. The United States was very pleased when Saudi Arabia and Oman applied for WTO membership. We support their participation in the WTO on terms that bring their trade regimes into conformity with WTO provisions and provide for enhanced transparency and market access in the Saudi Arabian and Omani markets on the basis of WTO obligations and concessions. Support for countries' accession to the WTO, however, is not demonstrated by silence during the negotiations. Support in the WTO is shown by participation.

We have participated actively with other WTO members to determine the terms of accession for both countries: in the Working Party meetings where current trade regimes and their relationship to WTO rules are discussed; in bilateral meetings where specific issues are identified and discussed; and in bilateral negotiations for tariffs and services. The phrase "terms of accession" goes back to the earliest days of membership expansion under the old GATT 1947. What it means in practice is that the applicant country negotiates an "entry fee," i.e., a body of commitments, that brings it up to the current level of commitment in WTO with other members. The precise scope and level of certain commitments undertaken to join WTO, e.g., for tariff levels or services-market access are, in fact, matters of negotiation. Adherence to WTO rules, however, is a different issue. One can negotiate the approach to the rules in an accession process, but one cannot negotiate the rules themselves.

Negotiations for the terms of WTO accession involve a number of steps. The process is time consuming and complex. After receiving an application for accession, the WTO Council establishes a Working Party to conduct the negotiations. The accession applicant describes its trade regime to the Working Party, and WP members make suggestion for improvements to bring it into line with WTO rules. In parallel with this, there is a country-to-country negotiation to establish bound tariff levels and specific services commitments. At the end of the process, you have a protocol of accession and Working Party report which says, in effect, "This country is now in the WTO, and here are additional specific commitments to implement WTO rules."

In parallel, the bilateral negotiations for tariffs, services, and agricultural supports and subsidies are consolidated into two schedules of specific market-access commitments on goods and services. These schedules are attached to the protocol of accession and to the Working Party Report, which contains the text of the commitments. This package is adopted by the Working Party and transmitted back to the General Council for ultimate approval by the whole WTO. The actual work is done in the Working Party discussions and in bilateral negotiations. The outline of the agreement between the applicant and the WTO members is often known well in advance of the formal completion of the process. However, pulling all the elements of the accession package together; making sure all WTO members agree to the terms negotiated, and making sure implementation in the key WTO areas has been achieved can take additional time.

Progress towards completion of WTO accession negotiations is not determined by the number of meetings that have occurred nor by the length of time since negotiations were initiated. Rather, the pace of the accession process is mostly determined by the applicant itself, because the applicant country is the one that has to make the critical decisions on when to adopt WTO principles and when to finalize the negotiations on maximum tariff levels and services openings.

Concerning transitional arrangements, all WTO accession applicants are expected to incorporate WTO disciplines into their commercial legal framework. In general, they are expected to undertake these changes during the accession process and not afterwards. Transitions are granted, but these transitions are functional, not an indefinite postponement of action to implement WTO provisions. To justify transitions, countries need to make a credible case (a) that they have attempted or are attempting in the accession period to implement WTO, and (b) that the transition requested is narrowly focused and of short duration with benchmarks for interim action towards full implementation that can be demonstrated and monitored.

We have a difficult situation now in the WTO with the transitions that were included in the original WTO Agreement in 1995. A number of countries apparently saw the five years provided as a transition as a lengthy period and did not take timely action in the interim to implement their commitments. Some of the transitions provided expired January 1, 2000. The situation is understandable because countries face many competing demands for action and may have to focus their energies on meeting other demands. And there has been no immediate rush within the WTO to penalize these countries. I often say that "there are no GATT police, and there are no GATT jails." But the essence of participation in the WTO is compliance: compliance with the rules towards other people's trade so that you can expect the same treatment for your exports.

None of this is easy. But the United States and the other current WTO members have come through eight rounds of market-access negotiations since the establishment of the GATT over the past 52 years. Current members have a right to insist that new members of the organization bring their level of openness, or at least their level of participation in the system, up to roughly the same level. It is of little value to current WTO members to admit a new member who is not prepared to comply with WTO provisions. The larger the applicant economy, the more difficult the negotiations are likely to be. By the same token, large economies are expected to have a large impact on the system. They're expected to play leadership roles in Geneva. Therefore, they are expected to negotiate significant commitments to the system that they are joining.

We are very enthusiastic about the decision of both Saudi Arabia and Oman to become members of the WTO, and that the value of WTO membership to them will be substantial. WTO is a forum for countries to project their interests in the international field. The WTO Agreement provides an instantaneous trade agreement with 135 other countries that protects exports, provides a guide to policy and a forum for discussion and negotiation, and acts as an advertisement to firms and individuals that this country is prepared to conduct business under known rules. We believe that WTO accession with its emphasis on establishing stable and transparent rules and commitments to liberal market access for goods and services will help both countries meet the goals they have already set for themselves, both in terms of economic growth and the development of their economies. The requirements for WTO accession support plans already in place in both countries for economic diversification and the expansion of private-sector opportunities and domestic employment. Adoption of WTO requirements should also foster a more attractive investment climate.

AmB. FREEMAN: I think it is good news that those who work on this issue in the U.S. government are as enthusiastic as Cecilia Klein suggests about the truly historic decision that Saudi Arabia and Oman are making. It is no exaggeration to say that Oman until recently had been virtually closed to the outside world. This decision to join the world on the world's terms economically is a logical extension of the whole process of opening and modernization that Sultan Qaboos has overseen.

In the case of Saudi Arabia, it is the only traditional monarchy not to have been invaded by missionaries or foreign soldiers during the period of Western colonialism. The West came to Saudi Arabia as hired help rather than as conquerors or in a superior position. And, except for the Haj, it's been easier to get a visa to go to Tibet than to Saudi Arabia, even though there is a great deal more business to be done in Saudi Arabia than in Tibet. So the decision of Crown Prince Abdullah and others that Saudi Arabia must now welcome the world on the world's terms rather than only on Saudi terms, in the interest of Saudi Arabia and in the interest of developing the Saudi economy, is historic. It is an opportunity that I hope will be seized.

ABDELALI JBILI, assistant director, Middle East Department, International Monetary Fund

I would like to assure those of you who associate the IMF with countries in trouble that the GCC countries are not in trouble; they are in good shape. The IMF has relations with all member countries, including the GCC countries, whether they need its financial assistance or not. Today I will focus on what I consider the most important challenge for these countries in the next decade which is how to raise growth and emploment of GCC nationals. Other challenges include the economy's vulnerability to fluctuation in oil prices, preserving the oil wealth for future generations, and assuring financial stability. But today I would like to focus on growth and employment only.

Let me give you a quick glance at the economies of the six GCC countries. They have small populations, 28 million, 20 million in Saudi Arabia alone. They have 44 percent of the world's proven oil reserves, and account for 20 percent of the world's oil production, 23 percent of the world's oil exports, 15 percent of the world's proven natural gas reserves, and 40 percent of Middle East and North Africa's combined GDP (gross domestic product). In addition, the GCC presents the observer with some unusual features among developing countries. First, these countries have higher per capita income, which runs from $6,000 to $7,000 in Saudi Arabia, to $18,000 in the United Arab Emirates and $22,000 in Qatar. Yet the GDP per capita has been declining over the last 10 years or so. These countries attract a large inflow of foreign workers, yet there is rising unemployment among their nationals. These countries have sizable financial assets, most of which are invested in industrialized countries, yet they need foreign direct investment.

And finally, these states have a dynamic entrepreneurial class, yet governments are dominant in economic activity.

I would like to review the reasons behind the low growth performance in the GCC countries, examine the employment paradox and the structure of the labor market. Then I will outline a strategy- from the IMF point of view - to raise investment, growth and employment of GCC nationals.

In 1998, the growth rates in the GCC countries were lower on average than in developing countries, where the growth rate was 5 percent, and in Asian countries, where, even after the recent crisis, it was 7 percent. In the GCC countries growth was only 2.5 percent on average. Per capita growth rates in the GCC countries during 1970-99 have been negative, while in the developing countries they increased by 60 percent, and in Asian countries by 160 percent.

What are the main reasons behind this poor growth performance? First, low investment. The investment ratio to GDP in the GCC countries was about 20 to 23 percent on average, and this is below the level of developing countries. The reason for this is that, after a period of sharp increase in government investment in infrastructure and utilities in the '70s, most GCC governments scaled back their public-sector investment in the subsequent period. The second reason is the low private-sector participation and investment, which is due to the dominant role of governments in economic activity. The third is what we call the total-factor productivity growth - the factors that contribute to growth other than capital and labor. There are some empirical studies that show that total-factor productivity has been negative in the GCC countries. Finally, the ceilings on crude-oil production that are set by OPEC tend to weigh down real GDP growth. As mentioned before, the government dominance of economic activity restricts the scope of privatesector investment and growth.

Most governments in the GCC countries are aware of these issues and have put in place strategies to increase investment and growth. I would like to highlight what we in the IMF think is are the ingredients for a successful strategy. First, the GCC countries need to have higher and more productive investment, and they need to attract foreign direct investment. There are limitations on how much the public sector can shoulder in terms of investment to upgrade the infrastructure, to produce electricity, and to generate growth in utilities. Since the public sector is faced with fiscal constraints, it is clear that the bulk of investments and growth cannot be generated in the public sector. It cannot also be generated in the oil sector, because of limits on output increases. However, in countries such as Qatar, Oman and the UAE, there is considerable growth potential in the gas sector. Therefore, a growth and investment strategy must focus on the non-oil sector and the private sector.

Finally, growth must translate into higher employment of GCC nationals and not on increased reliance on expatriate workers. These countries need a healthy dose of privatization. They need to open up to foreign investment, improve the regulatory environment, strengthen and deepen financial systems, put in place labor-market reform, and make progress in transparency and dissemination of information. These are not totally new policy prescriptions; the governments are already implementing some of these reforms. But the strategy must be comprehensive and bold enough to produce the desired outcome.

Let me take up these issues one by one. In the GCC countries there is widespread public-sector ownership in almost all sectors - in oil, upstream and downstream, in transportation, in banking and in insurance. Government ownership ranges from 45 percent in the UAE to 70 percent in Kuwait. The GCC countries are making some progress in privatization, for example, in telecommunications and privatization of utilities, but they need to broaden the scope of this reform and accelerate privatization.

There are some trends in this direction. In the UAE the authorities are now considering privatizing hospitals and even the management of certain educational institutions. In addition, to make privatization more credible, the IMF has been suggesting in bilateral discussions that the authorities set up some administrative institutional arrangements, for example, high level committees or ministerial departments to deal with privatization. This will help accelerate the process and strengthen the commitment of the authorities to privatization.

Concerning the need to open up to foreign investment, the GCC countries have an overall net-creditor position. But they need foreign investment to facilitate the transfer of technology and know-how and to meet financing needs of investments in infrastructure and utilities, that clearly cannot be undertaken by governments. In many of these countries legislation is already underway to increase foreign ownership of companies to 100 percent, to reduce the tax bias against foreign firms, and to provide other incentives to foreign investors, such as tax holidays and tax-free zones.

With regard to the regulatory environment, there are some reforms underway to revise and modernize company laws, investment codes, and customs and tax regulations. Some of these reforms are being considered in connection with accession to the WTO. Others like enforcement of contracts, collection of debt and liquidation of collateral are also under consideration. There is also a need to reduce red tape.

Turning to the financial sector, the banking sector in general is sound; the banks are healthy and well-capitalized, but what is needed is the development of capital markets and equity markets to provide additional means for private-sector financing.

Let me turn now to what I call the employment paradox. As I mentioned before, the GCC populations are small but increasing rapidly, at 4.1 percent per annum. The GCC economies generate employment in excess of the local supply, so they attract a large number of expatriate workers. But the labor markets are segmented between nationals and expatriates, and between the public and private sectors. The reasons behind such regimentation include differences in wages and benefits, skill mismatch between nationals and expatriates, and the preference of GCC nationals for public-sector jobs, while the private sector has a preference for expatriate workers.

I will review quickly the main elements of the labor-market reform that is underway in some countries. Most of the GCC governments have established quantitative targets of employment of nationals in certain private companies. They are also providing incentives for hiring and training nationals, and they are trying to increase the cost of foreign labor through visa fees and other fees. We think that these measures alone cannot make a dent in the problem, i.e. reduce significantly unemployment among nationals. Even worse, if these targets are applied without flexibility, they could hurt private-sector competitiveness. We would like the GCC countries to consider reducing the differential in wages and benefits between the public and the private sectors. In some countries there is consideration of extending social allowances to nationals in the private sector. Also, greater emphasis must be placed on training and improving the educational system in these countries. Finally, there is merit in considering introducing unemployment benefits and reducing government hiring.

To summarize, the reform strategy for the next decade must be comprehensive and integrated: government disengagement from economic activities, private-sector participation, opening up to foreign investments, and financial-sector and labor-market reform.

AMB. FREEMAN: Dr. Jbili, you have just outlined a process of truly revolutionary change the introduction of transparency, tax reform, law and regulatory reform. I did not hear you mention it, but of course underlying all of this is the idea of national treatment for investors and foreign participants in these markets, which have so much potential.

KEVIN R. TAECKER, globalization consultant, Enterprise - Saudi Arabia People from different cultures at different times and in different places have always found ways to trade and build markets. Markets don't just happen over night. They are created out of a set of understandings about how the market should run: understandings about the practical aspects of trade that are often tacit but are increasingly explicit. Our discussion today is about the development of global markets, and the best next steps to extend the global rules-based economy. For international finance and trade in services, technology and intellectual property, business has burgeoned since the World War II as result the process for developing the global rules. Indeed, this process has sown prosperity around the world, radically changing the economic landscape to lift hundreds of millions out of poverty, and bring hope to billions.

Developing a global rules-based economy has been a complex process, somewhat akin to weaving a fabric. There are "threads" pertaining to various aspects of international business. As things stand, this fabric strongly reflects its Western origin - our institutions, interests and endowments. Indeed, today's global markets are founded on the abundant availability of water and the invention of water-powered machines. Today's global economy was born out of Europe's industrial revolution and the first global trade in textiles and other manufactures.

But when we think about the Middle East, where there never has been that abundance of water to power industrial looms, the approach to weaving is different. There, a good weave reflects considerable skill and care, and the result is much more elaborate and durable. Anybody who has ever bought an oriental rug will understand how the threads are tied together in knots by hand. A Middle Eastern tapestry or rug is made for the long-term, often for centuries. What is most important is its durability and its beauty. One of the central issues facing the GCC region in its efforts to join the global-rules based economy is that much happens at a very fast pace and with short time horizons. In the Arab world, doing business involves consideration not just for this generation, but for the next.

When we consider where to take the rules- based economy around the world, we are looking at something more akin to a tapestry than a broadcloth. If you step back from what we have so far, you can see that there are flaws. In some areas the fabric is frayed, and there are holes reflecting spotty participation from large and important market regions. And we all need to be concerned that the fabric will not tear again, as it did in Asia during their recent economic crisis. Despite how far the global rules have come, there could still be serious setbacks, and there is clearly much more room to develop the world's full economic potential. Thus, there needs to be continuing progress in discussions about the global rules at the IMF, the Basle Committee, and the WTO - particularly at its upcoming "Seattle Round" of global negotiations.

In the world of the WTO, we are also seeing that there are limits. Hear what the environmentalists and labor unions had to say in their protests in Seattle. For them, the absence of rules in areas that interest them represents a serious fraying of the system. There are also setbacks to the process. We have seen one quite recently in Europe, where the the European Union is shunning Austria - suspending its day-to-day business out of concerns about its internal politics. In other words, there are limits to the notion of rules-based trade. Understandably, the developing countries that are just now considering to accede to the global system are having to pause and think. For the GCC, it is important to appreciate and work with their particular approach and orientation.

Dr. Jbili explained the compelling reasons for the region to join the WTO, the system of rules-based trade. If you have a good fabric for the working of your economy, you can create and support greater transaction volumes and larger markets. This will, in turn, foster the kinds of investment, business and economic-opportunity creation that is needed to generate new jobs. By becoming part of the global rules-based economy, the Middle East region can take-off from its flat growth path to achieve sustained high levels of real growth, in line with the rapid growth of the region's population.

How does rules-based trade relate to policies of liberalization? If you were to take the point of a compass and put one tip of it in Oman and the other edge of it in Jeddah and draw a circle, and then do the reverse, you would describe the natural market region of the GCC. It covers Iran, goes into the Caspian to the north, touches the Indian subcontinent to the east, and covers some of Europe and much of North Africa to the west. Within that region there are many traditional trading lines that cut across the current political lines. So when Saudi Arabia considers making this long-term change, it must shift its attention to see new areas for future development.

In the Gulf today there is a real debate going on, particularly in Saudi Arabia, on whether or not this kind of shift of focus is really necessary or worth it. Recent developments might tend to favor those who say, "We don't really need to make this set of major compromises. We can do pretty well just by focusing on our own region and trying to do more with our neighbors." This has become clear in recent months with the rise in the price of oil. Following Prince Abdallah's 1997 trip to Tehran, Saudi Arabia and Iran were able to put animosities aside and agree to cooperate on the oil-producers' agreement that fueled last year's doubling of crude-oil prices. Just ten days ago, a delegation of Iranian officials and businessmen came to Riyadh to sign a protocol for greater merchandise trade. There's a great deal of emphasis now on tariff unification in the GCC and on developing the Arab common market. Such efforts help to knit local markets more closely together. That pull to stay with what is local and familiar will always be there.

However, there are many businessmen and government officials who already have ample experience dealing in the global economy. They understand completely the need to be more fully integrated with the world, and the importance of accepting and working with the rules. But they live within their own political process. They have to contend with the resistance to change.

Last October, a delegation of senior Saudi businessmen visited Washington. They called on the administration and the Hill, and engaged in dialogues with private think tanks and business organizations. They came to ask for U.S. support for Saudi Arabia to join the WTO. Their message was good, and it is worth taking into account here. They want to be part of the system and support its goals. Because of the population growth and liberalization, new business opportunity is opening up. They want global partners and can contribute capital and skill to dealing in their broad natural market area. Against those who oppose the WTO or would limit or constrain its reach, Saudi Arabia and the Saudi business community represent a potentially strong ally for the United States in the process for developing a prosperous global economy.

The global rules-based economy is a broad and varied fabric, and there are no simple formulas. For Saudi Arabia, at least, joining the WTO is the centerpiece that puts into order a whole agenda for liberalization and reform. The Saudi businessmen who visited Washington were saying, "We are ready to pin our futures as community leaders on coming to tell you this. America's support for Saudi Arabia's membership in the WTO is very important to the success of leadership in the Saudi economy for the long-term. America can help to give the business community, the private sector, the momentum that it will need in order to meet the economic goals that Dr. Jbili discussed so well.

AMB. FREEMAN: I think you're right to point out that it's not an obvious decision on the part of the Gulf countries to answer the problems that Dr. Jbili outlined, of declining per capita income and low GDP growth in relation to other countries, as well as fiscal crisis, by opening up. Yet they seem to have determined to answer these challenges by opening up. I think for people in the region, this will yield major opportunities in terms of increased rates of return on investment, opportunities to repatriate capital that is now invested abroad, to invest it in their own countries, and expanded opportunities to attract new technology and know-how through foreign direct investment. Finally, there's a sort of realization of the dream of those who ruled these countries at the time of the initial oil boom. They wanted to use government to create an environment in which eventually the private sector could take the lead. This is exactly the transition that the current generation of leaders now seems determined to carry out.

SHAFEEQ GHABRA, director, Kuwait Information Office

Let me take you to the region for an inside-out view rather than an outside-in view, to create a widening of understanding. With the end of the Cold War, the Gulf states and the region at large discovered more and more that there is one broad road to economic development, to change, to improvement, to advancement. In the past, there was a socialist and a capitalist world. We had our hands in both. We had a fine private sector, but one heavily dependent on the state. We had good ties with the West and fair ties with the East, and it worked well. The socialist model was, after all, a model that dominated over two thirds of the world's countries. Suddenly we realized that there is one world and had to adjust.

Is politics one-dimensional or multi-dimensional, with many views and many interests? Should we have a dominant state or a state with a smaller role and less impact on the economy and on life in general? Is our concept of sovereignty the fully isolated independent state or is our concept of sovereignty more limited? Does it interfere with the activities of subgroups or multinational groups? Is our concept of the community a single community or one made up of many subgroups and forces? Is our concept of religion an orthodox one or is it more open, with different interpretations and applications that would allow modem life to proceed? Is our concept of our own history glorious or can it be criticized and evaluated in a factual and realistic way?

These issues have a life of their own cutting across generations in the Gulf. The young try to be more pragmatic and flexible, and the older generation still holds to traditional concepts of economics, community and politics. But more pressing issues affect the balance between young and old. Seventy percent of the people in the Gulf are under the age of 25. Sixty percent are under the age of 21. About 50 percent are under the age of 15. That says a lot about the coming of a new generation. It also tells us much about the problems that are going to be faced as we try to provide schooling, medicine, employment and growth in a society that is experiencing such a high rate of population growth. So the generational issue is embedded in the conceptual divides between past, present and future. Internal pressures are centered on many issues, among which employment, education, growth, self-expression and individual rights are the most visible.

There are also external effects related to the global reality we live in today. The surge in communications and the Internet are having a major impact on systems, structures and processes and on the young. Internet cafes are spreading in the Gulf, we see them everywhere in Kuwait. Young men and women are communicating across sectors and countries. These effects of globalization are becoming part of day-to-day life in schools and elsewhere. This has an impact on information. You cannot censor anymore. Traditional censorship of information is collapsing. People are plugging in everywhere and getting the information they need.

In other ways, the World Trade Organization, the IMF and the World Bank are all having a great impact on our systems. The impact is much more serious today than it ever has been in the history of the region. This process is not without resistance and resisters. Those who are trying to slow down global influences are also making their voices heard. The interchange adds to the external pressures improving our systems.

In brief, we are facing issues of transparency, accountability, privatization, limiting the state, communications, open versus closed systems, participation, power sharing, and facing up to corruption. This is a decade of change in the Gulf region. Today you see new policies in Kuwait, Saudi Arabia, Oman and the United Arab Emirates, but there are more to come.

One needs to keep in mind that Gulf rulers have been in power for decades and centuries. The At Sauds came to power between 1902 and 1934; the At Khalifa in Bahrain in 1783; the At Thani in Qatar in 1873; the rulers of the UAE in the mid-nineteenth century; and the At Sabah in the late eighteenth century. These small societies were able to face the challenges of gaining independence and building modem states during the wave of Arab nationalism in the fifties and the sixties. They absorbed the 1967 defeat of Palestinian nationalism and leftist movements in the region; they absorbed the effects of the revolution in Iran. There is a great deal of absorptive capacity in Gulf politics.

Overall, the region has been stable for a very long time, and there is no reason to think that this stability cannot continue, with contained disruptions. Basically, this is due to respect for social pacts, social rules and family balances. There is an ability to reconcile conflict internally between one faction of a family and another, even in the ruling family itself. This has contributed to a "wisdom of government" which has distinguished Gulf systems from many other Arab revolutionary "republics." The question ahead of us is this: How will the Gulf use this flexibility and adaptability to manage the needed and more difficult transitions of the future?

AMB. FREEMAN: For years there was ajoke that said that the national motto of Saudi Arabia, and by implication other societies in the Gulf, was progress without change, something which can only be achieved in the Arabian peninsula. But I think it's fair to say that what we have heard this morning reflects a recognition that without change there will be no progress in the Gulf, and there may even be decline. It seems that people in the Gulf now are increasingly willing to make very great changes, in the way they do business and organize their economy, in their own interests. But the changes they propose also happen to be in the interest of Americans. As friends, I think we should recognize the magnitude of the decisions that our friends in the Gulf are making and the difficulties that implementing these decisions will entail, and hold out a helping hand as they go forward.

We can do so confident in the thought that our interests will be greatly benefited by the changes that are in progress. Not only will we benefit from the greater stability that economies less dependent on a single commodity - energy exports - will bring to the region; but from the point of view of American business, there are going to be many greater opportunities from these changes than there have been in the past. Sectors that have been closed to foreign investment will open. There will be an expanded range of opportunities for American investors and business people to cooperate with their Gulf Arab counterparts. Because of the changes that are being contemplated and must be made in connection with WTO accession, there is also going to be an opportunity for considerably greater profit in those cooperative arrangements than has been the case in the past. So I take away from today's discussion a great sense of encouragement that all of this will be of great benefit to the United States.

Q: We've spent a lot of time this morning touching on one issue, the need for increased productivity in the region. The region does have a long history of entrepreneurism, but it's one that tends to be trade-based. Do you have specific opinions on what needs to be done more specifically to increase the productivity within the countries?

DR. JBILI: I would not describe these economies as trade-based. I think there are certain sectors that are doing quite well in terms of productivity, like the petrochemical industry and the energy-intensive industries. Besides education and lack of management experience, there are other factors like bureaucratic red tape, customs clearance and visas that may hinder productivity. But, in general, the environment of the GCC is conducive to competitiveness and productivity. Inflation is very low, in the range of I percent, and even negative in some years. The exchange rate is stable; the infrastructure is adequate; the private sector benefits from expatriate workers at competitive wage rates and adequate skills. But to increase productivity, the whole environment for doing business needs some improvement. There are also some cumbersome regulations, like the commercial law, the company law and the judiciary system that should, for example, facilitate the liquidation of collateral. There is a whole range of issues that must be dealt with to raise productivity. MR. TAECKER: It is hard to generalize across the whole economy on productivity issues, but I think two things are missing. One is a generally more competitive environment. These are countries which, by virtue of oil income, have been able to be very fussy about how they organize their own internal markets. Their markets still have substantial barriers to entry in some areas, such as for service-oriented businesses and banking. Just opening up to competition will create incentives for improving productivity. The other area is innovation or lack of it, from having been cut off from the way business is done in rest of the world. The high levels of productivity gains that we have enjoyed reflect the very fluid and rapidly changing ways that our businesses can organize and operate. The Gulf economies have not participated fully in that phenomenon. By liberalizing, they will be able to attract new foreign partners and participate in productivity innovations. It all comes back to the basic agenda for liberalization and reform, which in the Gulf case is closely tied to being able to join the WTO and, once in, to seek steadily increasing harmonization with its precepts.

DR. GHABRA: Productivity will become a serious issue as we see reform in the public sector, particularly as the governments become less and less able to hire young graduates of universities and colleges. Many young graduates of American universities are not satisfied being employed in the public sector, and they start looking for something else. They find the public sector very slow for them. And, therefore, they end up thinking privately. The more we can get people trained in how to start their own business and how to do a small project, the better. This is where the growth is going to be, where wealth is going to be built in the future, not in the public sector. People there are competitive.

This trend is clear among young people today. A lot of small companies, public relations companies are being formed. In Kuwait when we have elections young people come to you wanting to manage the campaign of X candidate or Y candidate. They're doing ads, doing speeches. If we open opportunity, get reform and training, productivity will improve.

Ms. KLEIN: I would like take as my point of departure the last statement of Dr. Ghabra's. A great deal of the value of WTO accession will be seen in its impact on domestic development. The immediate impact, e.g., on the date of accession, doesn't seem that great, but over time, the increased transparency and predictability of the rules for international trade has a positive effect on both international and domestic trade. Trade is trade, and money is money, whether or not you cross national boundaries. WTO requires an economy to relax rigidities and constraints on international trade or at least to organize these measures in a predictable, internationally acceptable form. By doing that, the rules for domestic economic actors are changed as well. In many economies, this is where the real value-added from WTO accession takes place. Exports gain from the protection of WTO rules as they are shipped overseas, but an additional benefit comes from the regulatory reform that has to take place throughout the domestic economy and from market access and other commitments that give the economy an added predictability. Market-access commitments also advertise a country's willingness to accommodate investments.

There are other benefits. When one thinks of foreign investment, it is natural to think of a manufacturing firm. But under the WTO, half of the market-access commitments are in specific service sectors: environmental services, computer services, professional services. Services is an area in which economies are now seeing great employment expansion. Foreign suppliers of services enter a market, bringing in the idea, and then develop it with local employment. I think WTO can play a major positive role in this regard.

Q: As part of the WTO accession process, a private-sector and maybe a public information campaign on the WTO, for people to know what it is, what it does, might help. Is it possible that the OPEC system of restricting oil supply to increase world market prices might in the future be challengeable under WTO rules?

Ms. KLEIN: I can't speculate on whether or not OPEC would be addressed in a WTO context. OPEC has existed for a long time; the GATT and the WTO have existed for a while. It would be up to the current WTO members to decide. I think this is an issue that is probably preoccupying some of the countries already in the system and those joining.

As for popular outreach for accessions, the WTO Secretariat, the United States, and other members do the best we can to ensure that applicant countries understand and can implement WTO rules. We offer technical assistance, and as we negotiate, we try to spread the message that in our view the WTO will benefit the applicant. But if a country wants to join the WTO and spread the word on WTO benefits to its people, it's up to them to do it. We will be as helpful as we can.

The implications of WTO on national sovereignty are practically nil. A member country is completely and utterly sovereign in how it operates vis-a-vis WTO. It joins WTO if it wants to. It conveys information on WTO rules and benefits to its citizens on its own terms. And it conducts its business within the WTO as it deems most beneficial to its interests. There may be consequences if members operate outside WTO rules, i.e., if a country breaks the rules, other members may complain and seek dispute settlement or some sort of arbitration of the problem. But this is not the same as undermining a member's sovereignty.

AMB. FREEMAN: As a footnote, I might add that about a year ago we had a very interesting discussion at one of these fora on the pressures for reform in the Gulf oil monarchies which addressed, in part, your question on OPEC. I would refer you to Volume VI, Number 4 (June 1998) of Middle East Policy.

Q: The GCC countries recently agreed on a harmonized tariff schedule for their proposed customs union but agreed to delay the implementation of it until 2005. Do you view this step as a reflection of a true political commitment on the part of the GCC heads of state to go forward with the customs union, or are theyjust pushing this off for another debate in the future? It seems to me that there are a lot of problems in the tariff rates that are going to be set between the low-tariff-rate countries like Bahrain and the UAE and countries that set higher tariff rates like Saudi Arabia and Kuwait. Will there be any kind of reneging on WTO commitments if countries like Bahrain and the UAE wind up raising their tariff rates as a result of the customs union? And will the customs union provide a framework for the free-trade agreement that the GCC has been talking about with the EU since its inception?

MR. TAECKER: My impression is that the commitment is quite serious. It's been a long hard road to this point, and my understanding from people who were very close to the final negotiations leading up to the announcement of the tariff-unification commitments is that the bargaining was real and the commitments that are involved from the countries are real. The long time frame for unification reflects respect for the difference between those that have very low tariffs and those whose tariffs are higher. Specifically, we are thinking about the UAE, where the government has to go back to their business communities and say that it will have to reorient itself by capitalizing on rising business volumes around the Gulf, rather than just On their own local low tariff rates. These are basic changes that cannot be made overnight.

As for Saudi Arabia, my understanding is that their tariff-related offers are largely within range for the WTO. Thus, the discussion about tariffs is more of a transition issue than an essential or 'core' issue. In my judgment, they could make the basic commitments needed to be a new WTO member in good standing very soon. But for the very specific issues involved with harmonizing this or that particular economic subsector, there are some real and sensible transition factors to address. It will take time, but I don't think that affects the core commitment, or that it is in America's best interest to get the region fully into the WTO as soon as possible.

DR. JBILI: I think 2005 is the maximum deadline. This means that any GCC country can implement the agreement before 2005 if it wants to. What is left during this period of transition is very limited because essential commodities are exempt, and the disagreement on, let's say, the differences in position between the UAE and other countries like Saudi Arabia covers only a small portion of trade. So I don't see these as a major problem in the future.

With regard to the tariffs, the GCC member countries that have already acceded to the WTO had their tariffs bindings at much higher rates than those now prevalent among the GCC countries. On the free-trade agreement with the European Union, there are discussions underway, but I think there is a major hurdle: the discrimination against petrochemical products by the European Union. Until that problem is solved, I don't think there will be any progress in that area.

DR. GHABRA: I believe it is serious, and it wasn't an easy agreement to come to. There were many differences, and if it weren't for Saudi Arabia and the willingness of all states to come together on these issues, it would have not been agreed upon.

Q: What is the major component of the GDP of these countries besides oil? What is their market besides oil? What do they produce? And Ambassador Freeman, because you have experience in those countries, what do you think the U.S. can do to avoid making Osama bin Laden a hero to Third World Islamic masses?

DR. JBILI: Apart from oil, these countries have an industrial base -the petrochemical industry, some light industry. The service sector also is very developed, as are banking and financial services. In countries like Bahrain and UAE, for example, the financial sector is quite developed. You have trade, both domestic and international, and government services. All of these are components of GDP. But oil still accounts for 30-40 percent of GDP. Nothing can replace oil. But these countries can manage without oil. Remember that during the 1991 regional crisis, Kuwait lived for almost a year or more without revenue from oil. Some countries, like Saudi Arabia, for example, have sizable financial assets, both public and private, on which they draw when oil prices and revenue decline. In 1998, we lived through a major oil shock. Prices declined by one-third, and yet the GCC countries managed fairly well. There was a bit of speculation against the Saudi riyal, but this was no real threat, and there was no devaluation or financial crisis. The authorities managed to get through the emerging markets crisis. I think they can do that in the future as well. In addition, the private sector also has great financial wealth. There are no official estimates, but some unofficial estimates put these assets in the range of $400 to $800 billion.

DR. GHABRA: Look at the United Arab Emirates, look at Dubai. It's managing without much oil, and there is a lot of trade and banking going on. They've been able to manage without much oil. Bahrain does not depend on oil that much. It manages. Kuwait historically has been has been a trading center servicing both Iran and Iraq. Once there is no oil, and even much before that, I think Kuwait should be able to get back on its feet as a trading center, servicing Iran and a rehabilitated, renewed, productive Iraq. We are working on diversification, looking for new sources of income, investment in knowledge and information, in computers and new systems. Hooking yourself up to the globe becomes the way by which you can manage a future that will come after oil.

AMB. FREEMAN: With regard to Osama bin Laden, I'm not sure that WTO or economic reform are the answer to that problem. But I agree with the thrust of your question. It is not in the interest of the United States or anyone else to exaggerate the role or appeal of Osama. He was thrown out of his own family for misbehavior, he was stripped of his Saudi citizenship, and he is decidedly not a hero to the majority of people in the Gulf, nor is he an emblem of Islam for all but a few fanatic followers. The problem represented by Osama is much exaggerated and misrepresented in the Western press. We would do well to recognize the very limited popular base of support that rests under him, while also recognizing that you don't have to have popular support to be capable of acts of murder and terror.

Q: My question involves the Saudization of the workforce. Might Saudis with less experience in the work environment than the expats they are replacing lower productivity and therefore competitiveness? Who's going to train them, and who's going to pay for it? What are the implications for competitiveness and attractiveness to foreign investment?

MR. TAECKER: Since the late '80s and early '90s, the big development is Saudi Arabia's "Resolution

50." That established quantitative requirements whereby all businesses, new and old, are expected to have increasing numbers of Saudis on their staffs. So part of the answer to your question is, yes, businesses have to take some of that burden.

Saudi Arabia spends a great deal on education and has generous incentives and programs to help with training. The big difference since the 1980s, however, is on the supply side of the labor market. Today there are many more Saudis entering the workforce and looking forjobs. So the laws of the market are beginning to apply. What you have to pay for a Saudi is starting to come down, and businesses are starting to see that their investment to train and develop their Saudi personnel pays them back in terms of higher productivity. For many global companies, Saudi Arabia actually presents a much better situation than you will find in other parts of the world. In Saudi Arabia, the general level of education is higher, the government's support is more generous, what you start with is better, and - because of the many emerging business opportunities - the effort promises to be more worthwhile.

AMB. FREEMAN: One of the great changes over the past seven-and-a-half years since I ceased to reside in Saudi Arabia on a continuous basis has been the appearance of Saudis in many jobs that traditionally were performed by expatriates. My experience with these Saudis generally has been very positive. They do their jobs, and they do them effectively. So some of the concerns of the business community have not been borne out in practice.

Q: Who sets the rules of the WTO, and who's going to enforce them, particularly in the Persian Gulf region, considering the fact that the resources of Iran and Iraq and the population of those countries are three times as great as the GCC? I wonder whether, without oil and gas, they have a form of economy valuable enough to be considered a part of the World Trade Organization.

AMB. FREEMAN: The best answer to the issue you raise of non-oil economic activity is to be found in the example of the United Arab Emirates, where, particularly in Dubai but in some of the other emirates as well, trade entrepot activities are now much more important than the oil trade as a factor in the economy. This demonstrates the potential of the Gulf more generally if it has the right policies and economic environment to develop business outside the oil sector.

Ms. KLEIN: Neither Iraq nor Iran is in the WTO accession process, nor are they WTO observers. They were not GATT members either, although they used to attend some of the major meetings as observers. When the time comes that Iraq and Iran are in the position to join the organization, there will be a discussion of their trade regimes, there will be a negotiation, and sooner or later there will be a conclusion.

But there's a misunderstanding here as to what the WTO is. The members set the rules. There's a Secretariat in the WTO of perhaps 400 people, a relatively small international bureaucracy. A country gets a great deal out of membership in the WTO because it's member-driven. It's the members that do the work, the members that make the rules, the members that, if the rules appear to be broken, bring it to the attention of the member they think is violating it. There are no WTO police, no WTO jails. If there is a disagreement with another member, it is taken to dispute settlement, not to a court of law. That's all that can be achieved - a ruling that settles the dispute. What happens after that ruling is decided by the countries involved. If a country loses the case and is asked to change its practices, the best course of action is to comply and change the practice. But if it can't comply, it can offer compensation in the form of additional market access. Or perhaps the losing country can't provide compensatory market access for one reason or another. In this case, the country that brought the dispute may seek authority to retaliate, e.g., to restore balance by raising duties on trade from the losing country.

But there is no way to force action against a country's will, even when it loses a dispute settlement case. The WTO, like the GATT before it, was organized to help countries formulate mutually agreed rules of commerce. It is not a coercive organization. You don't have to join if you don't want to, and you certainly don't have to stay if you find that it no longer serves your interests. But with very few exceptions, most member countries have decided, even when they lose a dispute-settlement case, that they want to stay.

Q: I import non-oil industrial products from the Gulf to the United States. I wanted to raise an issue I've had experience with, which seems a bit unfair in terms of treatment of the high-GDP Gulf countries. It has to do with labeling these countries "developing," for purposes of WTO accession and ultimately for purposes of tariff payments here in the United States. When I import from Gulf countries, I end up paying tariffs. These are nascent industrial economies, in no way a threat to U.S. industrial production. Yet their competitors - Turkey, Brazil, Russia - are on this emerging-country list. When Saudi businessmen were here a few months ago, I showed a couple of them the list. I said, when I buy from you, I pay tariffs. If I buy from Turkey I don't. How does this issue get resolved? The World Bank considers Saudi Arabia a developing country. One hundred of the 135 WTO members are labeled "developing." How does one of these high-GDP countries with a small industrial sector get itself or its products on the emerging list for purposes of GSP?

Ms. KLEIN: You are talking about the generalized system of preferences (GSP), a one-way preference system that is permitted by WTO rules. WTO rules provide that all countries should give equal tariff treatment to all other member countries, but there are exceptions. One exception is for regional preferential arrangements, and the GCC will arrange itself within those rules when all the members are in the WTO and begin adjusting their tariff and other commitments to establish a common trade policy. GSP is another exception. It was established in the '70s to allow developed economies to reduce or remove tariffs on imports from developing economies. It is a voluntary, one-way preference system. Many WTO members offer GSP tariff exemptions, but no two GSP systems are alike. The EU offers a partial tariff reduction from the MFN (most-favored nation) rate, on a specific number of items. The U.S. system offers 100-percent removal of tariffs on a wide variety of goods, with certain limits and restrictions. U.S. rules say that the high-income countries you are referring to are not eligible for GSP treatment. As a unilateral preference system, GSP is provided selectively, and the restriction is that it must apply the eligibility rules on a general basis to all countries. The United States believes it meets those tests.

The good news is that the United States has an extremely low average MFN tariff rate. Some types of exports to some of the GCC countries face higher tariff rates. GCC countries can seek reductions in U.S.-bound tariff rates through WTO negotiations. And achieving lower MFN tariff rates, bound in the WTO, is much more satisfying than waiting for a unilateral reduction that can be rescinded. As those who have participated in the U.S. GSP system know, GSP tariff reductions operate in some years and are canceled in some years, as the U.S. Congress is not always supportive of the GSP tariff preferences.

AMB. FREEMAN: Just to SUM it up, if you have a market economy and a per capita income above a certain level, you're not eligible for GSP. We all know that in the case of the Arabian peninsula, this crude measurement is not a very effective means of judging the character of those economies. Saudi Arabia and Oman 50 or 60 years ago resembled Mauritania more than the ultramodern physical environments that they now present. But for purposes of GSP, for good or ill, the Congress, as I understand it, has simply decided that there is a per capita income cutoff. And for purposes of WTO accession other criteria are applied, and every country, as Ms. Klein said, is treated differently. China, for example, has a claim to be a developing economy and yet was not admitted to the WTO accession process on that basis. Nor does it get GSP, even though per capita income alone would qualify it for that.

Ms. KLEIN: U.S. MFN tariffs cannot be considered a barrier to trade, and it is unlikely that most trading decisions are made on the basis of the nominal level of the U.S. tariff. U.S. MFN tariffs are relatively low by any standards, and we have an enormous trade imbalance. That trade imbalance should indicate that we have a relatively open market.

[Author note]

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